

UNITED STATES BANKRUPTCY COURT  
NORTHERN DISTRICT OF CALIFORNIA

MORPHEUS LIGHTS, INC.,  
Debtor.

Case No. 96-54222 JRG  
Chapter 11

VARIABLE-PARAMETER FIXTURE  
DEVELOPMENT CORPORATION, a  
corporation,

Adversary No. 98-5089

Plaintiff,

**ORDER GRANTING MOTION OF  
VARIABLE-PARAMETER SEEKING  
AUTHORITY TO PROSECUTE  
ADVERSARY PROCEEDING**

vs.

COMERICA BANK-CALIFORNIA, a  
corporation, and PETER  
DALTON, an individual,

Defendants.

**I. INTRODUCTION**

On March 4, 1999, the Court heard Variable-Parameter Fixture Development Corporation's Motion for Authorization to Prosecute Adversary Proceeding Against Comerica Bank-California and Peter Dalton. At the conclusion of the hearing, the Court ruled orally on a portion of the motion and granted it subject to certain conditions. The Court then took under submission the question of whether Variable has alleged sufficient facts to

1 bring a claim for conspiracy to breach fiduciary duty against  
2 Comerica Bank and Peter Dalton.

3 For the reasons hereafter set forth, the Court finds that  
4 Variable has alleged sufficient facts to bring a claim for  
5 conspiracy to breach a fiduciary duty against Comerica and  
6 Dalton.

7 **II. FACTUAL ALLEGATIONS IN THE COMPLAINT**

8 Variable alleges in its proposed First Amended Complaint<sup>1</sup>  
9 that Comerica caused Peter Dalton to be appointed as a state  
10 Court receiver for the debtor prior to the bankruptcy filing.  
11 After the filing, Comerica requested that Dalton become the  
12 Chapter 11 trustee of the debtor. As a result of the motion to  
13 appoint Dalton as Chapter 11 trustee, John Richardson, the CEO  
14 and sole shareholder of the debtor, resigned and Dalton became  
15 the new CEO. Dalton was allegedly paid \$240,000 in annual  
16 salary as CEO. Dalton thereafter released all claims against  
17 Richardson allegedly without evaluating the claims or their  
18 value. Under a stock pledge agreement, Richardson agreed to  
19 pledge all the stock of the debtor to Comerica for the alleged  
20 purpose of giving Comerica control over the stock and the  
21 operations of the debtor. The stock pledge agreement makes  
22 confirmation of a plan of reorganization by the debtor an event  
23 of default entitling Comerica to take control of all the stock  
24 of the debtor. During the same time period as the above  
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26 <sup>1</sup> The proposed First Amended Complaint is attached as Exhibit A to the "Notice of  
27 Motion and Motion by Creditor Variable-Parameter Fixture Development Corporation for  
28 Authorization to Prosecute Adversary Proceeding Against Comerica Bank-California and Peter  
Dalton."

1 transactions, an affiliate bank of Comerica acquired the right  
2 to a significant number of shares of Vari-Lite International,  
3 Inc., a principal competitor of the debtor.

4 The complaint also alleges additional conduct by Comerica  
5 demonstrating control over the debtor. Such conduct includes  
6 substantial control over the operations of the debtor, such as  
7 the ability to set officer salaries and to control payment of  
8 the debtor's debts and obligations, and control over the  
9 settlement of a pending patent infringement lawsuit by Variable.

10  
11 Variable also alleges that Dalton and Comerica have worked  
12 together to facilitate the acquisition of a controlling interest  
13 in the debtor and/or its assets, for the sole or principal  
14 benefit of Comerica and Dalton, and to the detriment of the  
15 debtor's unsecured creditors. For example, Dalton supported and  
16 adopted Comerica's position that the alleged debt to Comerica in  
17 the sum of approximately \$3.9 million is fully secured. Dalton  
18 and Comerica also allegedly worked together to facilitate  
19 Comerica's retention of \$1 million or more in post-petition  
20 interest payments. Furthermore, Dalton and Comerica allegedly  
21 impaired the ability of prospective bidders to compete fairly  
22 with Dalton for acquisition of the debtor's assets by refusing  
23 to produce information about the debtor and moving the debtor's  
24 operations to Redding, California.

25 **III. DISCUSSION**

26 Variable has asserted a claim for conspiracy to breach  
27 fiduciary duty against Comerica and Dalton. Variable argues  
28

1 that Comerica has exercised such control over Morpheus Lights  
2 that it has put itself in a fiduciary position and is capable of  
3 being sued for the breach of this duty. Comerica agrees that  
4 such a cause of action theoretically exists but argues that the  
5 facts alleged are not enough to satisfy what is required to  
6 assert the claim. Variable alternatively argues that, if it  
7 cannot sue on the conspiracy theory, it can proceed on the  
8 theory that Comerica induced Peter Dalton to breach his  
9 fiduciary duty. The Court finds that Variable has alleged facts  
10 sufficient to demonstrate a fiduciary duty between Comerica and  
11 the debtor. Hence, Variable's alternative argument will not be  
12 addressed.

13 Variable argues that Comerica is in fact a fiduciary of  
14 Variable. According to general corporate theory, a fiduciary  
15 includes an officer, director, agent, majority shareholder or a  
16 minority shareholder exercising actual control over the  
17 corporation. See In re N & D Properties, Inc., 799 F.2d 726,  
18 731-32 (11<sup>th</sup> Cir. 1986), citing 12B Fletcher, Cyclopedia  
19 Corporations § 5811 at 156-57 (1984). Variable claims that  
20 Comerica is a fiduciary because Comerica exercised that degree  
21 of control found in a fiduciary relationship.

22 To support its position, Variable cites In the Matter of  
23 Century Glove, Inc., 151 B.R. 327 (Bankr. D.Del. 1993), where  
24 the Court held that the debtor properly alleged facts which were  
25 sufficient to create a fiduciary relationship between the  
26 Chapter 11 debtor-in-possession, Century Glove ("Century"), and  
27 its primary lender, First American Bank of New York ("FAB").  
28

1 FAB had made a seven-year term loan in the amount of \$2 million  
2 and established a \$1 million revolving credit line for Century.  
3 FAB also acquired a security interest on the manufacturing plant  
4 and equipment and a floating lien on certain inventory, accounts  
5 receivable, and proceeds.

6 Century's theory that FAB was a fiduciary of Century was  
7 based upon the legal conclusion that Iselin, president and  
8 CEO of the debtor, was the "alter-ego, agent, and  
9 instrumentality" of the bank. See Century Glove, 151 B.R. at  
10 333. The Court held that, to pursue an "alter-ego" theory as  
11 the basis for showing a fiduciary relationship, it must be shown  
12 that the bank exerted "dominion and control" over the debtor.  
13 Id., citing In re Badger Freightways, 106 B.R. 971, 977 (Bankr.  
14 N.D.Ill. 1989). To support its control argument for finding a  
15 fiduciary relationship, the Court proposed two related, but  
16 independent, factual theories.

17 First, Century alleged that Iselin was a mere agent of FAB,  
18 that is, FAB's influence over Iselin was sufficient to cause him  
19 to act or fail to act as it directed. See Century Glove, 151  
20 B.R. at 333. However, the Court stated that the allegations by  
21 Century were insufficient because the complaint merely  
22 demonstrated a relationship between Iselin and FAB and a  
23 *potential* for FAB to influence Iselin. The Court explained that  
24 Century must allege specifically how FAB *actually* influenced  
25 Iselin so as to cause him to act as directed. The Court stated  
26 that "[t]he mere potential for control is not equivalent to  
27 control." Id.

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1 Second, Century alleged that FAB and Iselin had a common  
2 plan to control Century. The Court found that the complaint  
3 properly alleged a plan between FAB and Iselin to control  
4 Century with an objective of liquidating it to the benefit of  
5 them both, and without regard to the interests of Century. The  
6 Court carefully read the specific acts of misconduct of the  
7 complaint to determine which ones could reasonably be inferred  
8 as being consistent with this plan. Such acts of misconduct  
9 executed by Iselin with the assistance of FAB included the sale  
10 of machinery critical to productive capacity without Court  
11 approval and at less than market value; the sale of other  
12 machinery outside of the ordinary course of business without  
13 board approval, at an unreasonably low price, and with proceeds  
14 going to FAB; and causing monies to be paid to FAB that it was  
15 not entitled to under its loan agreement. Id. Thus, the Court  
16 found that Century had properly alleged facts sufficient to  
17 create a fiduciary relationship between the debtor and lender.

18 Similar to the Court in Century Glove, this Court has also  
19 discerned two related, but independent, factual theories in  
20 support of the control argument. First, Variable has alleged  
21 that Dalton is a mere agent of Comerica. In Century Glove, the  
22 Court did not find an agency relationship because the debtor  
23 failed to allege specifically how the creditor actually  
24 influenced the subject fiduciary to the extent to cause him to  
25 act as directed. 151 B.R. at 333-334. In this case, however,  
26 Variable has alleged that Comerica basically hand-picked Dalton  
27 to be in control of the debtor as State Court receiver and CEO  
28

1 of the debtor. Variable has also alleged that Comerica  
2 specifically influenced Dalton by compensating him with an  
3 annual salary of \$240,000.

4 Second, Variable has alleged that Comerica and Dalton had a  
5 common plan to control the debtor. Variable alleged that  
6 Comerica and Dalton worked together to facilitate the  
7 acquisition of a controlling interest in the debtor and/or its  
8 assets, for the sole or principal benefit of Comerica and Dalton  
9 and to the detriment of debtor's unsecured creditors. Dalton  
10 allegedly has, through the plan or otherwise, adopted and  
11 supported Comerica's position that the alleged debt to Comerica  
12 in the sum of approximately \$3.9 million is fully secured,  
13 notwithstanding substantial evidence to the contrary. Dalton's  
14 refusal to challenge Comerica's assertion facilitated Comerica's  
15 receipt of \$1 million or more in post-petition interest payments  
16 to which Comerica is allegedly not entitled. Comerica and  
17 Dalton have discouraged potential competition with Dalton for  
18 control of the debtor by refusing to give information about the  
19 debtor to potential investors on reasonable terms and  
20 conditions. The debtor abandoned the plan of reorganization and  
21 instead filed a motion to approve the sale of the debtor's  
22 assets to a new entity controlled by Dalton, which would give  
23 the new entity equity in the debtor corporation for a nominal  
24 investment. Comerica consented to the sale, which included the  
25 new entity assuming most or all of Comerica's alleged debt,  
26 subject to future renegotiation. The terms of the sale process  
27 halted competitive bidding for the assets, including the bidding  
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1 of Moving Lights Resource Organization, in which Variable is a  
2 shareholder.

3 Variable also uses In re American Lumber Co., 7 B.R. 519,  
4 529 (Bankr. D.Minn. 1979), to support its position. In American  
5 Lumber, the major creditor, First National Bank of St. Paul, had  
6 exercised control over all aspects of the finances and  
7 operations of the debtor. Such acts of control included payment  
8 of payables and wages, collection and use of accounts receivable  
9 and contract rights, purchase and use of supplies and materials,  
10 inventory sales, the salaries of principals, the employment of  
11 employees, and receipt of payments for sales and accounts  
12 receivable. The Court held that, by reason of control over the  
13 debtor and its operations, the creditor had the duty and  
14 obligation to deal fairly and impartially with the debtor and  
15 its other unsecured creditors. The creditor breached its duty  
16 by undertaking a course of liquidation that was designed to  
17 disadvantage general unsecured creditors and benefit the bank.  
18 In the interest of equity, the Court subordinated the bank's  
19 claim to the claims of general unsecured creditors. Id.

20 At this time, the Court does not believe that the dominion  
21 and control over the debtor alleged in this case rises to the  
22 level of control exercised in In re American Lumber Co. The  
23 complaint does not state that Comerica has exercised control  
24 over all aspects of the finances and operations of the debtor.  
25 However, taking all the allegations in the complaint as true,  
26 Variable has alleged conduct that amounts to a very significant

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1 level of control over the debtor.<sup>2</sup> Another case that Variable  
2 uses to support its argument is N & D Properties, Inc., 799 F.2d  
3 at 732, in which the fiduciary was a controlling shareholder,  
4 secretary and insider of the debtor. The Court held that a  
5 shareholder has control when she determines corporate policy,  
6 whether by personally assuming management responsibility or by  
7 selecting management personnel. Id., citing Berle, "Control" in  
8 Corporate Law, 58 Colum.L.Rev. 1212 (1958). The Court stated  
9 that the behavior of the secretary of the debtor indicated that  
10 she was acting solely for her own benefit to minimize risk of  
11 loss without any consideration for other creditors. Such  
12 pursuit of personal gain at the expense of other creditors has  
13 been recognized as a breach of fiduciary duty justifying  
14 equitable subordination. Id. citing American Lumber Co., 7 B.R.  
15 519.

16 Although the facts in the complaint allege similar behavior  
17 on the part of Comerica, N & D Properties is distinguishable  
18 because Comerica is not in fact an officer, director,  
19 shareholder or insider of the debtor. However, using the  
20 analysis found in Century Glove and American Lumber, the Court  
21 finds that the facts alleged in the complaint are sufficient  
22 enough to show a common plan to control the debtor and to  
23 demonstrate that a fiduciary duty does exist between Comerica  
24 and the debtor.

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27 <sup>2</sup> At the hearing on this motion, Comerica agreed that the Court should take all the  
28 allegations in the complaint as true for purposes of this motion. Comerica argued that, even  
if all the allegations are taken as true, the conduct alleged would still not rise to the level  
required to create a fiduciary duty to the debtor.

1 **IV. CONCLUSION**

2 Variable has alleged in the complaint sufficient facts to  
3 create a fiduciary duty between Comerica and the debtor. Hence,  
4 Variable has the ability to bring a claim for conspiracy to  
5 breach a fiduciary duty against Comerica and Dalton. The Court  
6 hereby grants Variable's motion to prosecute the adversary  
7 proceeding on behalf of the estate in its entirety, subject to  
8 conditions stated at the hearing.